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IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

No. 287

PEOPLE'S EDUCATIONAL CAMP SOCIETY, INC.,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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v.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

People's Educational Camp Society, Inc., petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit, entered on April 24, 1964, which affirmed by a 2-1 vote the decision of the Tax Court entered February 13, 1963.

Opinions Below

The opinion of the Tax Court (R.4a-33a)[1] is reported at 39 T.C. 756. The opinions of a panel of the court of appeals (App. A, *infra*, pp. 1-34) are reported at 331 F. 2d 923.

[1] Citation is to the Appendix to the brief of the petitioner in the court of appeals, which is Volume I of the three-volume record certified by the Clerk of the Court of Appeals for the Second Circuit. Nine additional copies of this Appendix, and nine additional copies of the Appendix to respondent's brief in the Court of Appeals for the Second Circuit (Volume II of the record certified by the Clerk of that Court) are being filed herewith.

Jurisdiction

The judgment of the court of appeals was entered on April 24, 1964 (App. B, *infra*, p. 35). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

Questions Presented

1. Whether the use and destination of the net income of a non-profit membership organization exclusively for social welfare purposes is the ultimate test of exemption from the income tax under Section 501 (c)(4) of the Internal Revenue Code of 1954.

2. Whether such an organization, whose net income is used, or destined to be used, exclusively for social welfare purposes is deprived of exemption from income tax under Section 501(c)(4) of the 1954 Code because it derives income from the operation of a summer camp for cultural and recreational purposes; or because its summer camp competes with summer camps operated by others for private profit; or because it has invested substantial income in capital facilities used exclusively for its own activities.

Statute Involved

Section 501 of the Internal Revenue Code of 1954 (26 U.S.C. §501), in effect during the year ended September 30, 1956 and here in question, provides:

> "Sec. 501. *Exemption from Tax on Corporations.* * * *
>
> (a) Exemption From Taxation.—An organization described in subsection (c) * * * shall be

exempt from taxation under this subtitle unless such exemption is denied under section 502, 503, or 504 [concededly not applicable here].

* * * *

(c) List of Exempt Organizations.—The following organizations are referred to in subsection (a):

* * * *

(4) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, * * *"

Statement

Petitioner is a non-profit New York membership corporation, without stock or stockholders, organized in 1920 by persons, mostly educators and teachers, associated with the Rand School of Social Science in New York City, which was the sole function and activity of the American Socialist Society, a non-profit New York membership corporation, held by the Commissioner of Internal Revenue exempt from income tax as a social welfare organization. The Rand School engaged in conducting adult classes of instruction and presenting lectures and programs related to the dissemination of information on the labor movement and socialist principles. In 1920, officials and friends of the Rand School became interested in purchasing a tract of 2,196 acres of land in the Pocono Mountains of Pennsylvania, for about $21,000, for the purpose of developing thereon a campsite where the Rand School's faculty, students and friends might gather during the summers to carry on their studies and de-

velop programs in which they were interested. Petitioner was organized to take title to the property and develop the summer camp, which was given the name "Tamiment," the name of a lake nearby. (R.6a-7a, 12a, 38a, 73a, 75a, 81a; App.A, *infra*, p. 2.)

Petitioner's certificate of incorporation states that its objects are to "organize, conduct and maintain summer camps and centers for instructive and recreational purposes"; to "diffuse a general knowledge of literature, art and science through the medium of lectures, publications and dramatic performances"; to "assist other educational, civic, political and economic movements and organizations"; to "cooperate with such organizations and movements and to initiate such movements".[2] Petitioner's certificate of incorporation also provides that none of its "activities" shall be "conducted for pecuniary profit to its members". (R.70a; App.A, *infra*, p. 4.)

Petitioner's by-laws provide that upon dissolution all of its property revert to the American Socialist Society, although that Society and its Rand School of Social Science ceased to exist in 1956. No plan of dissolution has ever been contemplated, and its assets upon dissolution would have to be distributed in accordance with the doctrine of *cy pres* (*Sherman* v. *Richmond Hose Co. No. 2*, 186 App. Div. 417, 175 N.Y. Supp. 8 (4th Dep't. 1919)). (R.8a-9a; App.A, *infra*, p. 5.)

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[2] In order to make it clear that petitioner had no authority to operate a school, there was inserted in the certificate of incorporation at the direction of the Secretary of State of New York that petitioner's "purpose shall not extend to those objects for which corporations may be formed pursuant to the Education Law". (R.70a; App.A, *infra*, p. 4.)

Petitioner is controlled by a group of individuals (doctors, teachers, civil service employees, business people) known as members, whose number may not exceed 35, and in 1956, the year in question, was 35. They are elected on the recommendation of petitioner's board of directors, by a vote of at least two-thirds of the members voting thereon. A member may be suspended or expelled by the members for conduct prejudicial to petitioner, or for failure to attend its meetings except for cause. None of petitioner's members, directors or officers receives any salary or other compensation, but the managing director and associate director, who conduct petitioner's day-to-day operations, receive salaries as do petitioner's other employees. (R.7a-8a, 41a, 74a; App.A, *infra*, pp. 3-4.)

Tamiment was opened for occupancy, on a modest scale, in 1921. It has at all times been open to the general public. Most of its guests have been intellectual adults, who have been attracted thereto by the facilities and activities there available. The guest rates, developed with the growth of Tamiment and adjusted somewhat to higher costs of operation, have been compatible with what such persons could afford to pay. These rates covered board and room, participation in all activities, and the use of all facilities (except for green fees at the golf course) at Tamiment. (R.9a, 12a, 84a; App.A, *infra*, pp. 5, 7.)

During the 20-year period from 1921 through 1940, Tamiment experienced a steady though moderate growth. From its inception through 1923, it financed is operations by small contributions and loans from many friends and supporters interested in the project. After this initial period petitioner did not rely on

contributions for its financial needs because it would have been unable to get a satisfactory response from the public; and since then it has been entirely self-supporting. The Commissioner of Internal Revenue held petitioner exempt from income tax for all years before the year in question, from its inception through its fiscal year ended September 30, 1955, as a social welfare organization under provisions of the income tax laws the same as the provision of Section 501(c)(4) here in question. With the benefit of the income tax exemption accorded to it, and under the conditions existing during the period from 1941 through 1955, petitioner then substantially expanded and modernized its facilities and thereby increased its guest occupancy[3] and activities. (App.C, *infra*, pp. 37-38; R.9a-10a, 12a, 42a-45a, 46a-51a, 78a-79a, 82a-83a; App.A, *infra*, pp. 5-7, 17, 32.)

The percentages of petitioner's *operating*[4] revenue which it expended for its activities (exclusive of capital additions) in the fiscal years 1956-1960 are approximately as follows: 80% in 1956, 80% in 1957, 76% in 1958, 81% in 1959, and 96% in 1960. In these years petitioner expended for additions to its fixed capital assets (land and buildings, equipment, and library in

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[3] Petitioner's guest occupancy increased from 17,910 guest-days in 1922 to 40,779 guest-days in 1939 and 70,940 guest-days in 1947, after which it declined to 60,479 guest-days in 1955 and 55,065 guest-days in 1959. It had 60,283 guest-days in 1956 and 57,423 guest-days in 1960. A guest-day is a day of residence at Tamiment by one guest, whether or not the same guest. (R.46a)

[4] That is, petitioner's gross revenue from all sources less its operating costs (which consist of its cost of board and room for the guests at Tamiment; its costs of maintenance of the facilities at Tamiment, including depreciation; and general administration and publicity), the balance being the total revenue available to it for the conduct of all of its other activities (App.C, *infra*, pp. 37-38).

New York City) substantially more than it then added to its Reserve (i.e. bookkeeping surplus account) from its operating revenue. (App.D, *infra*, pp. 39-40.)

On the basis of petitioner's expenditures considered by the majority of the court of appeals (Judge Hays dissenting) for social welfare activities, with the exclusion therefrom of all of petitioner's other activities, the percentages of petitioner's *operating* revenue which it so expended in its fiscal years 1956-1960 are as follows: 53% in 1956, 60% in 1957, 54% in 1958, 64% in 1959, and 89% in 1960 (App.A, *infra*, p. 32; App.D, *infra*, pp. 39-40).

Acting under the name of "Tamiment Institute", which it has publicized, and employing an Educational Director under the supervision of an advisory committee,[5] petitioner has pursued its objects by promoting an expanding and varied program of educational and cultural activities which the Tax Court and the court of appeals have held to constitute social welfare, as follows (R.15a-16a, 18a, 48a, 66a-70a, 80a-81a):

Annual seminars and symposia, held at Tamiment, on important social and political issues at which public figures, government officials, and labor leaders have

[5] The committee has consisted of Daniel Bell, professor of sociology at Columbia University and chairman of the sociology department of Columbia College; Sidney Hook, professor of philosophy and chairman of the All-University department of philosophy at New York University; Professor Earnest Nagel of Columbia University; George Schuster, past president of Hunter College in New York City; J. R. Oppenheimer, of the Institute for Advanced Studies of Princeton University; and Reinhold Niebuhr, professor and vice president of the Union Theological Seminary, and lecturer at Columbia University on political philosophy (R.52a-55a, 66a-70a, 80a-82a, 102a-103a, 104a, 110a-111a, 113a-114a).

presented and discussed their views. (R.15a-16a, 52a-53a, 61a-62a, 76a);

Annual public forums conducted in New York City by a panel of prominent citizens, which have dealt with current domestic and international questions (R.15a-16a, 53a);

Annual essay contests for college and university students for which petitioner awarded prizes, and which elicited hundreds of thoughtful studies on timely and significant issues (R.15a, 61a, 62a);

Annual chamber musical contests to stimulate interest in American string quartet composition, for which petitioner awarded prizes for the best original works (R.15a, 57a-58a);

An annual book award luncheon at which petitioner awarded a prize for the best biographical book of the year, and several special prizes[6] (R.15a, 52a, 56a, 58a-59a, 61a);

Scholarships granted by petitioner to authors (R. 48a, 59a);

Public service advertisements in magazines sponsored by petitioner (R.16a, 40a, 65a); and

Pamphlets on matters of public interest published and circulated from time to time by petitioner (R.16a, 53a, 59a, 62a).

Petitioner acquired the library of the Rand School of Social Science in March 1956, which it renovated,

[6] The winners for 1950-1956 were: Rupert Hughs, Ethel Waters, Merlo J. Pusey, Whittaker Chambers, Carl Sandburg, Selman A. Wakesman, Elmer Davis, Gay Wilson Allen, James MacGregor Burns, and Reinhold Niebuhr (R.15a, 52a, 56a, 58a-59a, 61a).

catalogued and expanded, employing a qualified librarian and staff, which it has since maintained in New York City as a free public library housing one of the most complete collections dealing with the history of the labor movement, socialism, and communism (R.15a, 67a-70a, 74a-75a, 80a-81a, 83a, 103a-110a).

Petitioner's activities at Tamiment which the Tax Court and the court of appeals have held to constitute "cultural programs and activities", but, contrary to the dissenting opinion of Circuit Judge Hays, not to qualify as "social welfare" activities within the meaning of Section 501(c)(4) of the 1954 Code, consist of the following (App.A, *infra*, pp. 27-28):

Weekly lectures on art, music, literature, current affairs, anthropology, psychology and human relations (R.14a, 54a-55a);

Weekly concerts by vocalists and instrumentalists of international reputation (R.76a, 95a-99a);

Daily concerts and lectures on music by a resident professional pianist (R.97a-99a);

An annual four day music festival featuring outstanding chamber music orchestras and string quartets (R.14a, 95a-96a);

A subsidized experimental theatrical group composed of a professional director, writers, composers, lyricists, arrangers, designers of scenery and costumes, actors, actresses, dancers and others, which produced new and original plays (R.13a, 14a, 76a, 85a-86a, 87a-94a);

A professional orchestra for productions in the theatre (R.14a, 88a-89a);

A resident professional artist and art teacher giving instruction without charge in painting and drawing (R.14a, 99a-102a); and

Exhibitions of paintings and sculpture with an annual prize for painting (R.100a-101a).

Petitioner's only other expenditures in the years 1956-1960 were for physical recreation at Tamiment, and for scholarships and charitable contributions (excluded by the Tax Court and the majority of the court of appeals as "social welfare" or "cultural" activities), and for additions to its facilities, most of which it acquired before 1956, the year in question (App.D, *infra*, pp. 39-40). The exclusion of the scholarships and charitable contributions, obviously, was an oversight. The percentages which the physical recreation expenditures are of petitioner's operating revenue are: 14% in 1956; 10% in 1957; 10% in 1958; 12% in 1959; and 11% in 1960. The additions which petitioner made to its capital assets consisting of land, buildings, equipment, and Library in New York City in those years far exceeded its current operating revenue. (App.D, *infra*, p. 39.)

The Tax Court's decision was entered on findings and opinion by Judge Pierce, who stated therein: "True it is that both the recreational and cultural activities provided [at Tamiment] did benefit those who participated in them". But he excluded them from the "ambit of 'promotion of social welfare'" because "they were furnished for financial consideration, and were paid for by the guests as a part of the 'package rates' charged therefor". Having so excluded all activities at Tamiment as without a social

welfare purpose, Judge Pierce states that what to him "is even more significant, is the fact that petitioner's total revenues from all sources * * * were disposed principally in handling the operating expenses of said resort, in enlarging and improving the resort's facilities, and in making additions to petitioner's accumulated earned surplus".[7] Accordingly, Judge Pierce compared petitioner's expenditures for social welfare activities other than its activities at Tamiment with its total gross revenue from all sources (before the deduction of any costs or expenses) and its Reserve, respectively, and concluded therefrom that "only a relatively insignificant portion of such total revenue was expended in the promotion of social welfare activities"; and that petitioner was not, therefore, operated during the year ended September 30, 1956 "either exclusively or principally for the promotion of social welfare". (R.27a-28a)

The majority of a panel of the court of appeals, composed of Judges Waterman[8] and Smith, affirmed the decision of the Tax Court, with Judge Hays dissenting. (App.A. *infra*, pp. 1-34.)

In an opinion by Judge Waterman, the majority conceded that petitioner is a " 'civic league or organization', and, as it also appears that petitioner makes no profit which inures to the benefit of any private individual" the issue is "whether petitioner has op-

[7] The inference is clear that Judge Pierce erroneously regarded petitioner's facilities and its accumulated earned surplus as two separate and distinct assets, overlooking the fact that this surplus is merely the bookkeeping representation of it net assets, mostly consisting of land, buildings, and equipment. (App.D, *infra*, p. 39.)

[8] Judge Waterman did not hear the argument.

erated exclusively for the promotion of social welfare"; and agreed with the Tax Court that petitioner's activities other than its activities at Tamiment constitute "the promotion of social welfare as that term is used in Section 501(c)(4) of the Code" because they further the beneficial interests of the community as a whole. (App.A. *infra*, pp. 13-14. 18.)

However, the majority of the court of appeals, while conceding that the activities at Tamiment which the Tax Court held to be "cultural" are "no doubt broadening and beneficial" to Tamiment's guests, held those activities to be without a social welfare purpose on the ground that these activities were for the guests, who paid for them. (App.A, *infra*, p. 15.) On this premise, the majority held that petitioner was not operated "exclusively" for the promotion of social welfare:

(1) Because petitioner's expenditures for its activities other than its activities at Tamiment constituted a "small fraction" of its gross revenue from all sources (before deduction of any costs or expenses) and its surplus, respectively, and it spent substantial portions of its revenues in expanding and improving the facilities at Tamiment (App.A, *infra*, pp. 16-17);

(2) Because, accordingly, the application of the destination of income test to petitioner would be "an unnecessarily broad application of the test and one which would be out of keeping with the spirit and purpose of the social welfare exemption," and "ought not to be used" here (App.A, *infra*, pp. 19-20); and

(3) Because Tamiment operated in competition

with others in the Poconos area (App. A, *infra*, pp. 16, 22).

Judge Hays dissented from the majority, and in his opinion held (App. A, *infra*, pp. 27-34) that the purpose of the cultural and recreational activities at Taminent was social welfare; that concededly petitioner's summer camp "is not operated for the purpose of earning a profit for any objective except an admittedly social welfare objective"; and that that camp "has no such 'commercial purpose' as the Supreme Court found in *Better Business Bureau* v. *United States*, 326 U.S. 279 (1945)" because "its operation is not designed to benefit any group 'economically'." Judge Hays, upon analysis, found further, that the majority's exclusion of petitioner from the destination test is without authority or justifiable reason, and held that petitioner is a social welfare organization exempt from income tax under Section 501(c)(4) of the 1954 Code under the controlling destination of net income test, even if its operation of the summer camp be regarded as a commercial business.

Reasons for Granting the Writ

This case presents the critically important issue, which has caused confusion in the administration of the law, as to the proper standard to be applied in determining whether a non-profit organization is "operated exclusively for the promotion of social welfare" so as to be eligible for income tax exemption under §501(c)(4) of the Internal Revenue Code. The decision below has not only contributed to the confusion but has evolved a standard which jeopardizes

and negates the tax exemption which Congress intended to give to innumerable social welfare organizations. Only this Court, through the invocation of its review power, can eliminate the confusion and give definitive effect to the Congressional purpose.

1. The decision below has reached a result in direct conflict with the language of Section 501(c)(4) and with the decision of this Court in Trinidad v. Sagrada Orden, 263 U.S. 578.

Section 501(c)(4) of the Internal Revenue Code provides in pertinent part that a nonprofit organization "operated exclusively for the promotion of social welfare" is entitled to exemption from the federal income tax. The court below, however, has interpreted this language to exclude from its coverage an organization so operated that its net revenue from an operation found to be commercial and competitive in nature are destined and used exclusively for concededly social welfare purposes.

In other words, Section 501(c)(4) has been limited by the ruling below to those social welfare organizations (1) whose gross revenue from all sources, *before* the deduction of *any* of its costs or expenses, is in *principal* part devoted to social welfare activities; (2) whose social welfare activities are limited to those for which it makes no charge; (3) which are of small size, with little or no facilities or accumulated earnings; and (4) whose operations and activities are not in competition with any taxpayer.

Such a construction of Section 501(c)(4) is in direct conflict with the plain language of the Code.

the intention of Congress, and the relevant guides to interpretation laid down by this Court and followed by other appellate tribunals. By itself, Section 501(c)(4) speaks only of an organization being "operated exclusively" for the promotion of social welfare, without reference to the commerical, profitable or competitive nature of the activities from which revenue is produced. The sole emphasis of the statutory language is on the exclusiveness of the social welfare purposes.

This Court has in effect confirmed the Congressional intent to make such a tax exemption turn upon the destination rather than the source of the organization's net revenue. While the Court has not had occasion heretofore to construe Section 501(c)(4),[9] the 1924 decision in *Trinidad* v. *Sagrada Orden*, 263 U.S. 578, with reference to the parallel exemption of religious organizations in what is now Section 501(c)(3), established relevant principles of construction which are in direct conflict with those utilized by the court below.

The *Sagrada Orden* case dealt with a religious organization that obtained the bulk of its income from rents, dividends and interest derived from "large properties in the Philippines, consisting of real estate,

[9] The exemption in question had its origin in Section G(a) of the Income Tax Act of 1913, 38 Stat. 114, 116, exempting "Civic leagues or organizations not organized for profit, but operated exclusively for the promotion of social welfare." This language was enacted in apparent response to a plea of the Chamber of Commerce of the United States that the exemption of religious, charitable or educational organizations was not broad enough to cover many non-profit organizations whose operations redounded to the benefit of the general public. See briefs and statements, Senate Committee on Finance, 63d Cong., 1st Sess., p. 20001.

stocks in private corporations, and money loaned at interest." 263 U.S. at 580. Additionally, a small amount of income was derived from "profits from occasional sales of some of its stock, and sums received, in excess of cost, for wine, chocolate, and other articles purchased and supplied for use in its churches, missions," etc. 263 U.S. at 580.[10]

Despite the commercial and profitable nature of the organization's real estate, investment and other activities, this Court held that the organization was entitled to a tax exemption since its net profits were all devoted to religious purposes and hence the organization was "operated exclusively" for an exempt purpose within the Congressional intendment. In so ruling, the Court stated (263 U.S. at 581):

(a) The statutory language as to being "operated exclusively" for an exempt purpose "recognizes that a corporation may be organized and operated exclusively for religious, charitable, scientific, or educational purposes, *and yet have a net income.*" [Emphasis added.]

(b) This statutory language "says nothing about the source of the income, *but makes the destination the ultimate test of exemption.*" [Emphasis added.]

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[10] The majority of the court below sought to dilute the impact of the *Sagrada Orden* decision by emphasizing that the wine and chocolate there involved were not sold to the public or in competition with others, but were bought and supplied for use within the organization's own agencies; these transactions were said by this Court not to amount to engaging in trade and the profit made was said to be "a negligible factor." See App. A, *infra*, pp. 21-22. But the bulk of the income in that case was from commercial real estate and other financial investments. That was the commercial source of revenue that this Court held to be immaterial in determining eligibility for exemption.

The teaching of the *Sagrada Orden* decision, which has never been repudiated or qualified by this Court, is that when a tax exemption turns upon proof that an organization is "operated exclusively" for an exempt purpose the destination or use of the organization's net profits is "the ultimate test of exemption." It thus matters not that the organization derives its revenue from some commercial operation, however profitable or competitive that operation may be. As was recognized in the *Sagrada Orden* case, 263 U.S. at 581, religious and other exempt organizations "cannot be carried on without money; and it is common knowledge that they are largely carried on with income received from properties dedicated to their pursuit. . . . Making such properties productive to the end that the income may be thus used does not alter or enlarge the purposes for which the corporation is created and conducted."

In short, if the use made of the ensuing profits is exclusively for an exempt purpose, the tax exemption is available. As stated in *Better Business Bureau v. United States*, 326 U.S. 279, 283, "to fall within the claimed exemption, an organization must be devoted [through use of its net profits] to educational [or other exempt] purposes exclusively. . . . [T]he presence of a single noneducational purpose [for use of its funds to benefit any group *economically*], if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes."

The *Sagrada Orden* ruling would seem to apply with equal force to the identical language of Section 501(c)(4), speaking as it does of an organization "operated exclusively" for the exempt purpose of

promoting social welfare. The conflict between the decision of the majority below and the *Sagrada Orden* decision thus becomes clear:

(a) The decision below expressly declined to apply or use the destination test to determine petitioner's eligibility for exemption, see App. A, *infra*, pp. 20, 26, despite the *Sagrada Orden* ruling that the destination of net profits is "the ultimate test of exemption."

(b) In declining to apply the destination test, the majority below concentrated exclusively upon the commercial, competitive and profitable nature of the activities which were the *source* of petitioner's revenue. But the *Sagrada Orden* ruling renders such emphasis impermissible. As long as the ultimate destination of the ensuing profits is for an exempt purpose, the tax exemption is available. Nothing was said in the *Sagrada Orden* opinion that would suggest that the size or commercial nature of the underlying activity affects the availability of the relevant tax exemption.

(c) The court below attached critical importance to the fact that "petitioner has, over the years, applied substantial portions of its income to expanding its business operations and to the building up of large accumulations of surplus." See App. A, *infra*, p. 22. But while expansion and accumulation to such a degree do not appear to have been involved in the *Sagrada Orden* case, the Court did recognize that "making such properties productive [presumably through expansion and reinvestment] to the end that the income may be thus used [for an exempt purpose] does not alter or enlarge the purposes for which the corporation is created or conducted." 263 U.S. at 581. Nor can such expansion destroy the exemption.

With respect to accumulation of funds, moreover, Congress has made plain that accumulation by a social welfare organization does not destroy or affect its exemption under Section 501(c)(4). Section 504 of the Internal Revenue Code denies exemption to charitable and other organizations described in Section 501(c)(3) if the amounts accumulated out of income during the taxable year or any prior taxable year and not actually paid out by the end of the taxable year are unreasonable in amount or duration in order to carry out the exempt purpose, or are used to a substantial degree for purposes or functions other than those constituting the basis for the exemption, or are invested in such manner as to jeopardize the carrying out of the exempt purpose. The obvious failure to make Section 504 applicable to accumulations by social welfare organizations exempted by Section 501(c)(4) renders irrelevant accumulations by such organizations. See *Erie Endowment* v. *United States*, 316 F. 2d 151, 156, fn. 21 (C.A. 3, 1963):

> "We assume, *arguendo*, as did the district court that if Erie can meet the specific tests for a civic organization, it can be tax-exempt under §501(c)(4) even if it had unreasonably accumulated income."[11]

(d) The refusal of the court below to consider net rather than gross revenue in considering the amounts applied to concededly social welfare purposes is in

[11] See also 6 Mertens, Law of Federal Income Taxation (Zinet rev. 1957), §34.18, ch. 34, p. 80: "Organizations exempt under Section 501(c)(4) are not subject to the tax on unrelated business income nor are they subject to the prohibited transaction or unreasonable accumulation rules which limit the activities of charitable organizations."

direct contradiction of the *Sagrada Orden* ruling. This Court made it plain, 263 U.S. at 581, that a corporation may be operated exclusively for an exempt purpose "and yet have a net income." It is the net income and the destination of that net income that is "the ultimate test of exemption." And as the dissenting opinion below noted, App. A, *infra*, p. 31, more than 53% of the net income was applied by petitioner to concededly social welfare expenditures, the remainder being used for its cultural and recreational activities, and for its facilities, at Tamiment.

These inconsistencies between the ruling below and the *Sagrada Orden* decision, as well as the plain misreading of Section 501(c)(4), make appropriate the grant of certiorari.

2. The decision below creates confusion and uncertainty in the administration of Section 501(c)(4) and jeopardizes the tax exemption of innumerable social welfare organizations.

Until the rendition of the decision below, it had been universally assumed that Section 501(c)(4) meant what it said—that an organization operated exclusively for the promotion of social welfare was entitled to tax exemption and that the ultimate test of such exemption was the destination of the net income derived from all sources. Lower courts, including the Second Circuit, generally followed the "destination test" formulated in the *Sagrada Orden* case in applying Section 501(c)(4).

Typical of this consistent approach was *Scofield* v. *Rio Farms, Inc.*, 205 F. 2d 68, 72 (C.A. 5, 1953), where

the Fifth Circuit noted the "great uniformity" stemming from the *Sagrada Orden* decision in applying to social welfare organizations the rule "that it is the use made of the profits rather than the source from which they are earned that determines the question of whether the corporation is, or is not exempt." The court there emphasized its inclination "to follow a liberal, rather than a cheese paring construction in considering and determining such claims for exemption." In *Hanover Imp. Soc.* v. *Gagne*, 92 F. 2d 888, 891 (C.A. 1, 1937), the First Circuit held that "civic leagues or similar organizations which are accorded an exemption do not lose it if some of their activities are carried on at a profit which is used to further the social welfare work."

And the Second Circuit itself, in *Debs Memorial Radio Fund, Inc.* v. *Commissioner*, 148 F. 2d 948 (C.A. 2, 1945), held that it was not fatal to exemption "that substantially all of petitioner's income is derived from commercial activities since the purpose of making profits has been to enable it to broadcast its educational, civic and cultural programs without charge . . . its ultimate purpose is the maintaining of a free public forum for educational, cultural and civic purposes without financial gain to any individual."

None of these cases can be reconciled in principle or result with the decision below. See also, as to an identical use of the "destination test" for organizations claiming exemption under Section 501(c)(3) and cognate provisions, *Roche's Beach, Inc.* v. *Commissioner*, 96 F. 2d 776 (C.A. 2, 1938); *Bohemian Gymnastic Ass'n Sokol* v. *Higgins*, 147 F. 2d 774 (C.A. 2, 1945); *Willingham* v. *Home Oil Mill*, 181 F. 2d 9 (C.A. 5,

1950), cert. denied, 340 U.S. 852 (1950); *Lichter Foundation, Inc.* v. *Welch*, 247 F. 2d 431 (C.A. 6, 1957); *Boman* v. *Commissioner*, 240 F. 2d 767 (C.A. 8, 1957); *Commissioner* v. *Howes Leather Co., Inc.* [reported *sub nom. Commissioner* v. *Johnson*], 267 F. 2d 382, 385-386 (C.A. 1, 1959); *C. F. Mueller Co.* v. *Commissioner*, 190 F. 2d 120 (C.A. 3, 1951); *The Lesavoy Foundation* v. *Commissioner*, 238 F. 2d 589, 590 (C.A. 3, 1956); *Texas Mobile Home Association* v. *Commissioner*, 324 F. 2d 691 (C.A. 5, 1963); *Arthur Jordan Foundation* v. *Commissioner*, 210 F. 2d 885 (C.A. 7, 1954; *Southeastern Fair Association* v. *United States*, 52 F. Supp. 219, 223, 100 Ct. Cl. 216 (1943); *Sico Co.* v. *United States*, 102 F. Supp. 197, 121 Ct. Cl. 373 (1952); *Knapp Brothers Shoe Manufacturing Corporation* v. *United States*, 142 F. Supp. 899, 902, 135 Ct. Cl. 797 (1956); *Veterans Foundation* v. *United States*, 281 F. 2d 912 (C.A. 10, 1960). These cases are analyzed more fully in App. E, hereto.[12]

The court below, by rejecting the "destination test" as to social welfare organizations, not only has rendered a decision in conflict with the hitherto established case law but has injected new, unwarranted and confusing concepts into the interpretation and administration of Section 501(c)(4). On what basis is the "destination test" to be ignored or modified? Is it the size or the extent of the profit-making activity? If so, is that size determinable by reference to gross or net revenue, or in comparison with other activities?

[12] In 1950 Congress removed the exemption of "feeder" organizations (now section 502 of the 1954 Code). However, it did not in any way limit the judicial application of the destination test of exemption of such organizations for any period prior to that amendment, or of any other organization for any period.

To what extent does the commercially competitive nature of such activity justify a modification of the test? What impact should there be from the fact that fees or charges are made for the use of certain facilities of the organization? And what role does the accumulation of income or assets play in determining the availability of a Section 501(c)(4) exemption? Is there to be a judicially-created counterpart of the Section 504 accumulation rules, which Congress confined to Section 501(c)(3) organizations?

These are but a few of the myriad problems that will plague all social welfare organizations by virtue of the decision below. These problems are compounded by the overt reliance by the majority below upon statutory provisions which Congress never intended to apply to social welfare organizations—Sections 502 and 511 of the Internal Revenue Code. See App. A, *infra*, pp. 25-26. While conceding (App. A, *infra*, p. 25) that neither of these sections "is squarely applicable to petitioner's situation," the majority thought that "they do shed some light on the problem confronting us."

As the majority below noted (App. A, *infra*, p. 26), these two sections were enacted in 1950 to prevent certain organizations with tax exempt status from competing unfairly with ordinary, taxed business entities. But Section 502 is plainly inapplicable to petitioner, for it deals only with the denial of tax exemption of "feeder organizations"—those organizations primarily carrying on trade for profit where the only connection with an exempt purpose is that the profits are all payable to one or more exempt organizations. And Section 511, imposing a corporate tax on the un-

related business income of charitable and other organizations otherwise exempt under Section 501 (c)(3), was expressly not intended to be applicable to organizations qualified for tax exemption under Section 501(c)(4). In the words of the Report of the Committee on Finance on the Revenue Bill of 1950 (Sen. Rep. No. 2375, 81st Cong., 2d Sess., 1950-2 Cum. Bull. 483, 504-505), with respect to these 1950 changes:

> "It is important to note that many organizations now exempt from income tax under section 101 of the Internal Revenue Code [of 1939] are not affected by these tax measures. * * * These include * * * 'civic leagues; social welfare organizations'; * * *.
>
> * * * *
>
> * * * In fact it is not intended that the tax imposed on unrelated business income will have any effect on the tax-exempt status of any organization. An organization which is exempt prior to the enactment of this bill, if continuing the same activities, would still be exempt after this bill becomes law. * * *"

Thus the court below, seeking to draw comfort from Sections 502 and 511 for its rejection of the "destination test" as to petitioner, has confused and aborted the special treatment which Congress has long given social welfare organizations. Congress at no time has exhibited any concern about unfair business competition by social welfare organizations; nor has it indicated any desire to tax their unrelated business activities. On the contrary, Congress has shown an affirmative desire to permit the social welfare exemp-

tion to continue to be guided as before by the "destination test." In other words, the test devised by this Court in *Sagrada Orden* and consistently followed by all courts up until now was intended to control.

If there are any problems created by the competition afforded by social welfare organizations in their commercial activities, they are problems to be answered by Congress rather than the courts. The failure of the court below to recognize that fact and its confusing attempt to legislate where Congress has remained silent call for the review and corrective action of this Court.

Conclusion

For these various reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted.

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APPENDIX A

Opinions of Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 63—September Term, 1963.

(Argued December 10, 1963 Decided April 24, 1964.)

Docket No. 28264

PEOPLE'S EDUCATIONAL CAMP SOCIETY, INC.,
Petitioner,

—v.—

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Before:

WATERMAN,* SMITH and HAYS,
Circuit Judges.

Petition to review a decision of the Tax Court denying petitioner an exemption from the income tax under 26 U.S.C. §501(c)(4) as a non-profit civic organization operated exclusively for the promotion of social welfare. Opinion reported at 39 T. C. 552. Affirmed.

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* This appeal was argued before a panel composed of Judges Clark, Smith and Hays. Judge Clark died before any opinion had been prepared, and thereafter Judge Waterman was substituted. Judge Clark had voted in a memorandum to affirm

I. HERMAN SHER, New York City, *for Petitioner.*

LOUIS F. OBERDORFER, Asst. Attorney General; John B. Jones, Jr., Meyer Rothwacks, Attys., Department of Justice, Washington, D. C., *for Respondent.*

WATERMAN, *Circuit Judge*:

This is a petition to review a decision of the Tax Court of the United States which upheld the Commissioner of Internal Revenue's determination of a deficiency of $25,784.43 in the federal income tax of petitioner, People's Educational Camp Society, Inc., for its fiscal year ending September 30, 1956. The Tax Court rejected petitioner's claim that it was exempt from the income tax under Section 501(*c*)(4) of the Internal Revenue Code of 1954 as a non-profit civic organization operated exclusively for the promotion of social welfare, rejecting it on the ground that such an exemption was precluded because of the relationship which petitioner's operation of a large commercial resort bore to its totality of activities. We agree that petitioner was not entitled to the exemption.

A complete statement of the facts surrounding petitioner's operations, including a detailed breakdown of its financial activities, can be found in the opinion of the Tax Court, reported at 39 T. C. 552. Our summary thereof follows:

Petitioner is a New York membership corporation with its principal offices in New York City. It was

organized in 1920 by persons associated with the Rand School of Social Science, an institution then operated by the American Socialist Society and engaged in conducting adult classes and presenting lectures and programs related to the dissemination of information on the labor movement and socialist principles. During 1920 officials and friends of the Rand School became interested in purchasing a tract of 2,196 acres of land in the Pocono Mountains of Pennsylvania, with an eye toward developing on the tract a campsite where the Rand School's faculty, students and friends might gather during the summers to carry on their studies and develop programs in which they were interested. After the school's executive secretary had acquired an option to purchase the land for about $21,000, petitioner was organized to take title to the property and develop the summer camp, which was eventually given the name "Tamiment," the name of a lake nearby.

Petitioner, organized as a New York membership corporation, has never issued any shares of stock and has never had any stockholders. Its operations are conducted by a group of individuals known as members, whose number may never exceed 35 and whose election to membership is governed by petitioner's bylaws. Any person may be elected to membership who has publicly endorsed the principles of socialism for at least two years, and whose membership has been recommended by petitioner's Board of Directors and has been approved by those persons already members. None of petitioner's officers or directors receive any salary or other compensation, but the managing direc-

tor and associate director, who conduct petitioner's day-to-day operations, do receive salaries as do petitioner's other employees.

When petitioner was organized its certificate of incorporation set forth its objects in the following terms:

> "To organize, conduct and maintain summer camps and centers for instructive and recreative purposes; to build, purchase, own, lease, manage and operate camps, dormitories, dining halls, recreation rooms, play grounds, reading rooms, halls and other buildings for the purpose of said corporation as herein set forth; to diffuse a general knowledge of literature, art and science through the medium of lectures, publications and dramatic performances; to borrow money for the corporate purposes of the corporation and to issue bonds, notes or other evidences of indebtedness therefor; to assist other educational, civic, political and economic movements and organizations; to cooperate with such organizations and movements and to initiate such movements, but said purposes shall not extend to those objects for which corporations may be formed pursuant to the Education Law, nor shall any activities of the said corporation be conducted for pecuniary profit to its members."[1]

[1] The limitation relating to the Education Law was inserted at the direction of the Secretary of State of New York to make it clear that petitioner had no power or authority to operate a school.

As of the time of the Tax Court proceedings below, petitioner's by-laws provided that upon dissolution all its property was to revert to the American Socialist Society, although that Society, along with its Rand School of Social Science, had ceased to exist in 1956. As of this time no steps had been taken to amend the portion of the by-laws relating to the disposition of petitioner's property upon dissolution, nor had any alternative plan for dissolution been contemplated.[2]

From the opening of Camp Tamiment for occupancy in July of 1921, it began to experience considerable growth. During its first twenty years its growth was steady though moderate. By 1941 the camp's annual gross income had increased to $281,633.87, and the value of its fixed assets had increased to $398,663.93. Except for the years 1925 and 1932, when small losses were incurred, Tamiment has each year consistently shown a profit, and, except for the period from 1921 to 1923 when petitioner received contributions, it has been entirely self-sustaining. In January of 1936, and again in January of 1939, petitioner obtained rulings from the Commissioner of Internal Revenue that, on the basis of facts then available, petitioner was entitled to an exemption

[2] No claim is made that, because of the demise of the American Socialist Society and the failure of petitioner thereafter to revise its by-laws relating to the disposition of its property upon dissolution, petitioner fails to qualify for a Section 501(c)(4) exemption on the ground that some of its property might eventually inure to the benefit of private persons. Petitioner claims, and the Government does not deny, that, as petitioner's by-laws stand, its assets upon dissolution would have to be distributed in accordance with the doctrine of *cy pres*. See *Sherman* v. *Richmond Rose Co. No 2*, 186 App. Div. 417, 175 N. Y. Supp. 8 (4th Dep't 1919).

under the then existing provisions of the tax laws, provisions which later came to be embodied in substantially the same form in Section 501(c)(4) of the 1954 Code.

Tamiment's operations from 1941 through the taxable year 1956 represented a second distinct phase of its development, one marked by a growth much more rapid and substantial than that previously experienced. This was manifested by considerable increases in operating expenses and in the value of petitioner's fixed assets and accumulated surplus. An analysis of petitioner's balance sheet figures for these years shows that petitioner's assets, which stood at $398,663.93 in 1941, had increased to $1,124,229.91 by 1951. By the end of the taxable year 1956,[3] the year here under discussion, these assets had grown to $2,301,604.74. During these same periods petitioner's surplus, designated in its balance sheet as "reserves," had increased from $311,079.97 in 1941, to $1,573,452.14 in 1951, and to $2,226,080.50 in 1956. Petitioner's annual revenues showed like increases after 1941, with the figures for petitioner's total gross revenues from all sources for 1941, 1951, and 1956 being, respectively, $290,804.60, $840,364.23, and $942,632.55.[4] The overwhelming portion of peti-

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[3] The figures showing the value of petitioner's assets at the end of its fiscal year 1957, as well as other figures for that year, were also set forth by the Tax Court. They indicate that the growth in petitioner's operations which preceded the taxable year 1956 continued at about the same rate during the next fiscal year.

[4] Figures stipulated for fiscal years subsequent to 1956 indicate that petitioner's growth as reflected by its annual gross revenue has continued an upward trend. Gross revenues for 1957 totaled $979,579.07, while gross revennes for 1960 amounted to $1,115,932.39.

tioner's gross revenues[5] and expenses[6] during the period under examination, as well as of the increase in the value of its assets, was connected solely with the operation of Tamiment.

By the year 1956 Tamiment had become the largest and one of the most modern summer vacation resorts in Pennsylvania, with rates ranging from $12 to $19 per day per person. As already noted, the American Socialist Society and the Rand School of Social Science, the motivating forces behind the creation of Tamiment as a site for summer retreats, had both ceased to exist. The resort was open to the public and competed with other vacation resorts in the Poconos. It employed more than 400 persons during the peak season and it advertised itself through newspapers, magazines and brochures as "Tamiment in the Poconos."

Tamiment's principal guest quarters in 1956 con-

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[5] The revenue figures for fiscal year 1956 are fairly typical. Of the $942,612.55 in total gross revenues, $929,611.17 came from the following sources: gross income from guests at Tamiment resort; gross income from rentals of bungalows at Sandyville, a section of Tamiment designed especially for use by families; and net income (no gross income or expense figures available) from taverns at Tamiment. Moreover, an additional $12,811.39 was realized as gross revenue from assets in the Mailly Educational Fund, which represents a segregation of a portion of petitioner's assets (derived largely from profits from Tamiment) which were placed in a special fund in 1944. While earmarked as a fund for educational purposes, the only disbursements which were made from the time of its creation through 1957 were annual payments of $2700 to help defray costs of operating a play school at the above mentioned Sandyville, and also, in 1956 and 1957, a minor portion of its assets were used in the erection of a new cultural center at Tamiment.

[6] See table in this opinion, *infra*, setting forth certain of petitioner's expenditures which were not directly related to Tamiment's operation.

sisted of more than 160 furnished cottages, capable of accommodating about 900 persons, and located adjacent to a dining hall with a seating capacity of 1000. Set apart from the main complex of cottages was a group of bungalows known as Sandyville, designed for use by families with children, and which adjoined a play school and a small store. The other physical facilities which dotted Tamiment's grounds were of the type not uncommon to luxury vacation resorts catering to a young adult clientele: An administration building; a library; a lecture and concert hall; a ballroom building; an 18-hole golf course with a clubhouse containing a cocktail lounge; another clubhouse and dining terrace overlooking Lake Tamiment; a theater building; and facilities for various outdoor sports.

Also, Tamiment's activities included organized programs in the fields of drama, music and art, all available to guests of the resort free of charge. On Saturday evenings and Sunday afternoons the theater building was the scene of a dramatic or musical production staged by a theater group employed by petitioner for that purpose, and throughout the rest of the week the building was used for the exhibition of motion pictures. Orchestras hired on theater evenings to play for musical comedies and revues were customarily used after the performances to provide music at dances. Each week during the summer season vocalists and musicians performed concerts or gave recitals, and a lecture dealing with a topic connected with the arts or with public affairs was also weekly fare for those staying at the resort. Throughout each summer season an art director employed by petitioner

gave free art instruction to interested guests, and professional artists were invited to display their works there and offer them for sale.

The most outstanding single cultural attraction at Tamiment was presented each year early in the summer vacation season, a chamber music festival featuring an orchestra and string quartet. The festival was open to members of the general public as well as Tamiment's paying guests, but a moderate fee was charged for those attending who were not staying at the resort.

Though the operation of Tamiment constituted the great bulk of petitioner's activities during the period under review, petitioner also carried on other activities at the time, chiefly in New York City. In 1951 it acquired from the American Socialist Society a building in the city which housed the Rand School of Social Science, the school's library, the offices of an independent publication called the New Leader, and the principal corporate office of petitioner. When the American Socialist Society was dissolved in March of 1956, and the operations of the Rand School accordingly ceased, petitioner acquired all of the assets of the school's library and, after renovating it and hiring personnel to staff it, began itself to maintain and operate the library. Containing one of the largest and most complete collections of material dealing with the labor movement, Socialism, and Communism, the library was made freely available to all persons engaged in research in those fields.

Acting under the name of "Tamiment Institute," petitioner also undertook to sponsor and promote various other programs of public interest, mostly in New

York City. In order to stimulate interest in American string quartet composition, petitioner promoted annual composition contests in this field of music, awarding prizes to original works adjudged the best. An annual book award luncheon was conducted, at which a prize was awarded by petitioner for the best biographical book of the year. Petitioner launched several programs to foster thought and discussion about important public issues. It discussed such issues from time to time in public service advertisements which it sponsored, and in pamphlets which it published and circulated itself. It also conducted numerous essay contests for college and university students. An annual public forum was held at which prominent citizens aired their views on matters of public concern, and, along these same lines, annual seminars were sponsored at Tamiment before the opening of the resort's summer season at which scholarly papers were read and discussed.

On March 3, 1956, the Commissioner of Internal Revenue wrote to petitioner, ruling that, inasmuch as petitioner was primarily engaged in operating a commercial enterprise, it was no longer to be accorded an exemption from federal income taxes. Petitioner filed a corporate income tax return for its fiscal year 1956 but claimed exemption from the tax, and the Commissioner asserted against it a deficiency of $25,784.13. In the Tax Court proceedings below petitioner did not contest the correctness of the deficiency figure, but unsuccessfully defended on the sole ground that it was not liable for any tax at all since it was entitled to an exemption under Section 501(c)(4) of

the 1954 Code. Section 501(c)(4) provides for an exemption from the income tax in the case of:

> "(4) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes."

Petitioner, of course, seeks to take advantage of that part of the subsection exempting "civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare."[7] To do so, petitioner must meet the three statutory conditions set forth in the subsection and demonstrate that: (1) it is a civic league or organization; (2) it is not organized for profit; (3) it is operated exclusively for the promotion of social welfare. *Debs Memorial Radio Fund, Inc.* v. *Commissioner*, 148 F. 2d 948 (2 Cir. 1945).

Conditions (1) and (2) do not require extensive treatment. While at least one court has given the subsection a rather limited construction by defining

[7] The requirement set forth at the end of the subsection, that net earnings be devoted exclusively to charitable, educational, or recreational purposes, appears to involve a narrower range of activities than does the term "social welfare." It is clear, however, from the language of the subsection and its legislative history that the limitation does not apply to all organizations covered by the subsection, but simply to the employee organizations described in the latter part of it. See *United States* v. *Pickwick Elec. Membership Corp.*, 158 F. 2d 272, 276 (6 Cir. 1946); *Hanover Imp. Soc.* v. *Gagne*, 92 F. 2d 888 (1 Cir. 1937). But see *Erie Endowment* v. *United States*, 316 F. 2d 151, 156 (3 Cir. 1963).

the initial word "civic" narrowly and then regarding it as modifying both "leagues" and "organizations," *Erie Endowment* v. *United States*, 316 F. 2d 151, 156 (3 Cir. 1963), neither party to these proceedings has raised any question as to the emphasis to be placed upon the word "civic" or the interpretation to be accorded it in construing Section 501(c)(4). Rather, they have both tacitly assumed that, even if the term does connote a limited genre of exempt organizations characterized by something other than social welfare operations, petitioner may be so classified, and they have confined themselves to an analysis of whether petitioner's operations in 1956 were exclusively of a social welfare nature.

This emphasis on the broader term "social welfare" is in line with the current regulations covering the subsection, which do not appear to give the word "civic" any real independent limiting effect but which only deal with organizations "operated primarily for the purpose of bringing about civic betterment and social improvements." Reg. §1.501(c)(4)-1(a)(2), and is also in line with revenue rulings interpreting this and predecessor subsections,[8] *e.g.*, Rev. Rul. 55-495, 1955-2 Cum. Bull. 259; Rev. Rul. 55-439, 1955-2 Cum. Bull. 257; GCM 24100, 1944 Cum. Bull. 192. This emphasis on the social welfare aspect of the subsection is also in accord with the weight of judicial authority; some courts apparently have not viewed the word "civic" as modifying "organizations" along with "leagues," and have therefore simply concerned

[8] In the rulings, "civic" is treated only as qualifying "leagues" and not "organizations," the latter term being regarded as modified only by the phrase dealing with social welfare operations.

themselves with whether an organization has been exclusively conducting social welfare operations, see *Veterans Foundation* v. *United States*, 281 F. 2d 912 (10 Cir. 1960); *Hanover Imp. Soc., Inc.* v. *Gagne*, 92 F. 2d 888, 891 (1 Cir. 1937); *Amalgamated Housing Corp.* v. *Commissioner*, 37 B. T. A. 816, 825, *aff'd per curiam*, 108 F. 2d 1010 (2 Cir. 1940), and other courts have reached about the same result by talking about "civic organizations" but not defining "civic" in the limited sense of "municipal" or "community sponsored" but in broader terms closely related to the general concept of the promotion of social welfare, see *Consumer-Farmer Milk Coop.* v. *Commissioner*, 186 F. 2d 68, 70 (2 Cir. 1950), *cert. denied*, 341 U. S. 931, 71 S. Ct. 803 (1951); *United States* v. *Pickwick Elec. Membership Corp.*, 158 F. 2d 272, 276 (6 Cir. 1946); *Debs Memorial Radio Fund, Inc.* v. *Commissioner, supra.*[9] This view is also supported by the little legislative history one finds in explanation of the provision, for when it was first made a part of the tax laws, Section G(a) of the Income Tax of 1913, c. 16, 38 Stat. 114, 116, it was apparently included as a result of a belief that the provision then exempting religious, charitable or educational organizations was not broad enough to cover many non-profit organizations whose activities benefited the general public. See Briefs and Statements, Senate Committee on Finance, 63 Cong., 1st Sess. 2001 (1913). Therefore, we, too, will assume that petitioner is a "civic league or organization," and, as it also appears that petitioner makes no profit which inures to the benefit of any private

[9] But see *Erie Endowment* v. *United States, supra*, at 156; *Commissioner* v. *Lake Forest, Inc.*, 305 F. 2d 814, 817-18 (4 Cir. 1962).

individual, we now concern ourselves with whether petitioner has operated exclusively for the promotion of social welfare.

Certain of petitioner's activities, not involving the commercial operation of the Tamiment resort, were found by the Tax Court to constitute the promotion of social welfare. These activities, which we have already outlined in some detail, were largely conducted in the New York City area and included such things as the maintenance of a free library on Socialism, Communism and the labor movement, the sponsorship of public forums and symposia, the promotion of musical composition and essay contests, and the circulation of pamphlets discussing important matters of public interest. We agree that these activities involved the promotion of social welfare as that term is used in Section 501(*c*)(4) of the Code. This court has characterized the promotion of social welfare as involving the serving of "purposes beneficial to the community as a whole," or the promotion of the "welfare of mankind" in the manner generally of the charitable, educational and religious organizations exempted by like provisions of the Code. *Debs Memorial Radio Fund, Inc. v. Commissioner, supra,* at 951. These activities of petitioner, designed in the main to stimulate increased interest in the arts and public affairs and to provide the general citizenry with means for becoming better informed as to matters of public concern, amounted, we think, to the furthering of the beneficial interests of the community as a whole and therefore served to promote social welfare.

Petitioner further urges us to characterize, as pro-

moting social welfare, the various cultural activities which were conducted at Tamiment, and which were connected with that area's operation as a commercial vacation resort. Our attention is directed to the lectures, concerts, plays, and art exhibits which were regularly held during the resort's summer season, and to Tamiment's annual four-day chamber music festival. We agree with the Tax Court, however, that these activities, considered in their relation to the total operation of Tamiment, did not involve the promotion of social welfare at all. They were simply part and parcel of Tamiment's operation as a commercial resort, and were necessary features of a luxury vacation spot catering to a young adult intellectual clientele. As the director of Pennsylvania's state tourist promotion agency testified below, such cultural programs, while perhaps of a higher quality at Tamiment, were not unusual programs for ordinary commercial resorts in the Poconos that sought to draw the type of guests who frequented Tamiment. These activities, while no doubt broadening and beneficial to Tamiment's paying guests who enjoyed them, and, therefore, in a very remote sense, doubtless of some incidental aid to the general community of which these guests were members, cannot by any stretch of the imagination be considered any more beneficial to the community as a whole or any more promotive of the general welfare, as those terms have been used to define the statutory phrase, than Tamiment's golfing, swimming, or dancing activities. See *Commissioner* v. *Lake Forest, Inc., supra; Consumer-Farmer Milk Coop.* v. *Commissioner, supra.*

We come now to the important question of whether petitioner's operation of the resort Tamiment, not in itself an activity involving the promotion of social welfare, prevents the petitioner from obtaining a Section 501(c)(4) exemption as an organization operated exclusively for the promotion of social welfare. The word "exclusively" as used in the statute has not been given a strict interpretation, so as to foreclose every operation for a non-exempt purpose no matter how insubstantial, but rather has been interpreted to mean "primarily." *Debs Memorial Radio Fund, Inc.* v. *Commissioner, supra, at* 952; see Sugarman & Pomeroy, Business Income of Exempt Organizations, 46 Va. L. Rev. 424, 425 (1960). Stated another way, "the presence of a single . . . [non-exempt] purpose, if substantial in nature, will destroy the exemption regardless of the number of importance of truly . . . [exempt] purposes." *Better Business Bureau* v. *United States*, 326 U. S. 279, 283, 66 S. Ct. 112, 114 (1945).

It was the nature of petitioner's operation of Tamiment as a commercial resort in active competition with other such businesses in the Poconos area, coupled with the relationship which the running of Tamiment bore to the total aggregation of petitioner's activities, that caused the Tax Court to conclude that petitioner was not operating exclusively for the promotion of social welfare. That court laid particular stress upon the fact that petitioner's expenditures for genuine social welfare activities constituted but a small fraction of its total revenues and paled in comparison with the total accumulated surplus which petitioner carried and which it had consistently in-

creased over the years. The following table, drawn up by the Tax Court on the basis of its findings as to petitioner's financial activities, excellently demonstrates this point:

Fiscal year ended Sept. 30.	Total Revenues	Expenditures for social welfare activities	Accumulated earned surplus
1953	$968,004.85	$13,378.44	$1,913,550.32
1954	956,911.51	28,550.86	2,036,911.38
1955	918,558.59	47,636.86	2,124,602.33
1956	942,612.55	44,684.76	2,226,080.50
1957	979,579.07	70,718.27	2,307,097.89

Moreover, petitioner spent substantial portions of its revenues in expanding and improving the facilities at Tamiment, with an extremely large addition to those facilities having been made during 1956, the taxable year here under review. During that year petitioner spent a total of $221,302.34 for capital additions. A comparison between petitioner's balance sheet figures for that year and those for the previous year indicates that of the total amount spent for capital additions, more than $200,000 was spent at Tamiment for buildings, equipment, and "permanent inventory," with the remainder being spent on books and equipment for petitioner's New York library.

We agree with the Tax Court that, under these circumstances, petitioner's operations at Tamiment foreclosed a determination that it is an organization operated exclusively for the promotion of social welfare. See *Scripture Press Foundation* v. *United States*, 285

F. 2d 800 (Ct. Cl. 1961), *cert. denied*, 368 U. S. 985, 82 S. Ct. 597 (1962). True, none of petitioner's revenues from Tamiment have ever been turned over as profits to any private person,[10] and petitioner's formally declared purpose as originally set forth in its certificate of incorporation when it was organized in 1920 was to conduct activities of a social welfare nature. Moreover, it may well be that the persons currently responsible for directing petitioner's operations sincerely and hoenstly believe that their organization's primary purpose is still the promotion of social welfare. Nevertheless, the exemption granted to social welfare and like organizations is made in recognition of the benefit which the public derives from their social welfare activities, *Trinidad* v. *Sagrada Orden, etc.*, 263 U. S. 578, 581 (1924), and we think it only fair to determine a particular organization's right to an exemption largely on the basis of the effect its operations have on the public. In terms of petitioner's purpose as demonstrated by the fact of its operations, and as demonstrated by the actual effect which those operations have on the community of which it is a part, petitioner cannot be regarded as primarily a social welfare organization entitled to a Section 501(c)(4) exemption, but rather it must be viewed

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[10] As noted earlier in our opinion, that an organization operates on a non-profit basis is only one of the requirements which must be met under Section 501(c)(4). In order to qualify for an exemption, an organization must also be operated exclusively for social welfare.

as an organiaztion whose primary purpose has in fact become the running of a commercial resort.[11]

Petitioner argues, however, that despite the relationship existing between its Tamiment expenditures and the amount of its revenues devoted to the promotion of social welfare, its Tamiment resort is no more than an income producing operation designed to finance its social welfare activities, and hence it is entitled to an exemption under the "destination of income" test. According to that test, first developed by this Circuit in 1938 largely on the basis of the Supreme Court's decision in *Trinidad* v. *Sagrada Orden, etc., supra,* the fact that an otherwise exempt organization conducts a commercial operation should not prevent the organization from qualifying for an exemption if the net income thereby realized is destined to be used for exempt purposes. *Consumer-Farmer Milk Coop.* v. *Commissioner, supra; Debs Memorial Radio Fund, Inc.* v. *Commissioner of Internal Revenue, supra; Bohemian Gymnastic Ass'n Sokol* v. *Higgins,* 147 F. 2d 774 (2 Cir. 1945); *Roche's Beach, Inc.* v. *Commissioner,* 96 F. 2d 776 (2 Cir. 1938).

While petitioner's argument is not completely unpersuasive, we think that to use the destination test to exempt this petitioner from the income tax would be an unnecessarily broad application of the test and one which would be out of keeping with the spirit

[11] Were petitioner *admittedly* operated for the primary purpose of running a non-profit vacation resort, it is difficult to imagine where a large segment of its revenues would go if not toward expanding and improving resort facilities, and accumulating large reserves of surplus.

and purpose of the social welfare exemption. The destination test ought not to be used to permit an entity to escape taxation where, as here, so much of its revenues are devoted to expanding its commercial facilities and increasing its surpluses, and so little of its revenues are actually spent for social welfare activities, that it is factually clear that the primary purpose of the organization is not really the promotion of social welfare but the running of a commercial operation.

Trinidad v. Sagrada Orden, etc., supra, the Supreme Court decision relied upon by this court as the original basis for the development of the destination test, provides no support for using that test in order to exempt an organization such as petitioner. In fact, a careful analysis of the facts before the Court in that case demonstrates that to use the destination test here would be to carry the rule developed from *Sagrada Orden* very far afield from the principles which were there set forth. The Court in *Sagrada Orden* interpreted an exemption which shielded from tax liability any corporation "organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual." The Government conceded that the entity, a Philippine corporation, was organized and operated for religious, charitable and educational purposes and that no part of its net income inured to the benefit of any private individual, but claimed that it was not operated exclusively for those purposes because of some income-producing operations which it

carried on. The great bulk of the income which was commercially derived consisted of rents, interest and dividends on properties which the corporation owned and held. The rest of it, consisting of only about 2.8% of the total income realized by the corporation during the taxable year involved, represented profits from the sale of wine, chocolate, and other articles used by the corporation's churches and various subordinate agencies. The Court held that the corporation was exempt from taxation, noting that the statute "says nothing about the source of the income, but makes the destination the ultimate test of exemption." 263 U. S. at 581.

What petitioner's argument fails to recognize is that the Court in *Sagrada Orden* when discussing the corporation's income producing operations took care to distinguish between its mere holding of property for the production of income and its merchandising or trading activities, a distinction which has also been recognized in certain current Code provisions which were in effect in 1956. Compare §501(c)(2) and §§512(b)(1)-(3) with §502; see H. R. Rep. No. 2319, 81st Cong., 2d Sess. 124 (1950). Thus, the Court in discussing the Government's position in that case, characterized it as one which put aside as immaterial both the fact that "the income from the properties" was devoted exclusively to religious, charitable and educational purposes, "and also the fact that the limited trading, if it can be called such, is purely incidental to the pursuit of those purposes, and is in no sense a distinct or external venture," 263 U. S. at 581; and, after explaining how the corporation in using its

properties to produce income was actually adhering to and furthering its exempt purposes, the Court turned to a discussion of the corporation's trading activities.

The Court emphasized the fact that the corporation's sales operations were quite small, did not involve any selling to the public or competition with others, and could not really be called "engaging in trade":

"As respects the transactions in wine, chocolate and other articles, we think they do not amount to engaging in trade in any proper sense of the term. It is not claimed that there is any selling to the public or in competition with others. The articles are merely bought and supplied for use within the plaintiff's own organization and agencies—some of them for strictly religious use and the others for uses which are purely incidental to the work which the plaintiff is carrying on. That the transactions yield some profit is in the circumstances a negligible factor. Financial gain is not the end to which they are directed." 263 U. S. at 582.

In the case at bar, of course, petitioner's Poconos resort operation is anything but small, and it competes actively for the public's business with other commercial resorts in the Poconos area. More importantly, unlike the corporation in the *Sagrada Orden* case, petitioner has, over the years, applied substantial portions of its income to expanding its business operations and to the building up of large accumulations of surplus.

Moreover, we find no substantial support for peti-

tioner's position in any of the cases in which this court has, through an application of the destination test, held certain organizations exempt despite their conducting of commercial operations. *Debs Memorial Radio Fund, Inc.* v. *Commissioner, supra; Bohemian Gymnastic Ass'n Sokol* v. *Higgins, supra; Roche's Beach, Inc.* v. *Commissioner, supra.*[12] The *Roche's Beach* decision, which granted an exemption to a "feeder" organization which did not itself conduct exempt activities but which channeled all of its profits to admittedly exempt organizations,[13] has been seriously undercut by a subsequent overruling amendment to the Internal Revenue Code enacted by Congress in 1950. Section 301(b), Revenue Act of 1950, c. 994, 64 Stat. 906, amending §101, Internal Revenue Code of 1939, and now found in §502 of the Internal Revenue Code of 1954. While the organizations held exempt in the two later cases conducted commercial

[12] In the one other case in which this court had occasion to apply the destination test, *Consumer-Farmer Milk Coop.* v. *Commissioner*, 186 F. 2d 68 (2 Cir. 1950), *cert. denied*, 341 U. S. 931, 71 S. Ct. 803 (1951), the organization under examination was found not to be organized and operated exclusively for social welfare purposes. Inasmuch as the decision turned largely on the conclusion that the organization's operations benefited individual members financially, it is of little aid to us as a guide to the proper handling of the present case.

[13] One of the reasons the majority gave for the result it reached was that the corporation would have been exempt had it, itself, been administering the exempt activities. 96 F. 2d at 776. The dissenting judge, Hand, *C.J.*, whose position as to the taxability of feeder corporations was eventually confirmed by congressional clarification of the then existing statute, argued that the exemption then given a limited class of feeder organizations was intended to be exclusive, and also indicated that even if petitioner were conducting the exempt activities itself only limited business operations could be carried on without loss of exemption. 96 F. 2d at 779.

operations to finance their educational or social welfare activities, such commercial operations were found to be merely incidental to their main tasks of either educating or of promoting social welfare. Neither of these cases involved commercial operations on the scale of petitioner's, and in neither of them, nor in the *Roche's Beach* case for that matter, was the organization using substantial portions of its revenues to accumulate large surpluses and to expand its income producing facilities.[14]

We think that more helpful guidance as to the proper tax treatment to be accorded petitioner can be found in certain remedial amendments which Congress in 1950 added to the Internal Revenue Code of 1939 and which have been carried over intact into the

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[14] In *Bohemian Gymnastic Ass'n Sokol* v. *Higgins*, an educational and recreational association realized income from the occasional renting of some of its facilities to the public, and from the regular operation of a bar and restaurant open to the public which grossed about $66,000 during the year 1942. There is no indication that any of this amount, which produced a net income of about $3,000, was used to accumulate surpluses or to add to the fixed assets of the commercial operation, except possibly part of that reflected by a $700 increase in the organization's inventory.

In *Debs Memorial Radio Fund, Inc.* v. *Commissioner*, a radio station originally organized for only public service broadcasting finding itself in financial distress, undertook to use a portion of its broadcasting time for commercial programing to finance its operations. Though no precise figures were included in the case as to the distribution of broadcasting time between public service and commercial programs during the taxable year, it appears that the majority of the total time, and all of the prime evening time, was devoted to public service broadcasts. Improvements in the station's facilities were made largely through advances from charitable foundations, but of course those improved facilities directly served public service purposes as well as helped to produce income. No sizable surpluses were accumulated; in fact, the court noted that up to the end of the period under review the station's operating expenses had exceeded its operating receipts by some $37,000.

1954 Code.[15] One of them, now Section 502 of the Code, was designed to clarify existing law, and we have already alluded to it briefly. Overruling the decision of this court in *Roche's Beach, Inc.* v. *Commissioner, supra,* it prohibited extending exemptions to "feeder" organizations, or to those which are conducted primarily as business operations but which turn over all of their profits to charitable, social welfare, or like organizations. Another 1950 amendment, now Section 511 of the Code, imposed a tax on the "unrelated business income" of certain organizations otherwise exempt from taxation. While neither of these amendments is squarely applicable to petitioner's situation, we think they do shed some light on the problem confronting us.

Section 502 of the Code, which denies exempt status though all its net income is ultimately channeled to truly exempt organizations, does so without regard to whether any of the particular feeder's gross income is first used to expand and improve its own capacity as a business. All feeder organizations, even those not interested in using *any* part of their gross revenues to expand their own operations, are declared taxable. In view of this we think it would be somewhat inconsistent, in dealing with the problem of the taxability of other organizations, to permit an entity like petitioner to attain exempt status while devoting considerable energy to improving and expanding an al-

[15] For a discussion of the legislation and its background history, see *Veterans Foundation* v. *United States*, 281 F. 2d 912 (10 Cir. 1960); *United States* v. *Community Services, Inc.*, 189 F. 2d 421 (4 Cir. 1951), *cert. denied*, 342 U. S. 932, 72 S. Ct. 375 (1952).

ready large business operation. Moreover, the Congressional purpose behind the 1950 enactment of both the feeder provision now in Section 502 and the unrelated business income amendment now in Section 511 was to prevent organizations with tax exempt status from competing unfairly with ordinary, taxed business entities. See S. Rep. No. 2375, 81st Cong., 2d Sess. 26-31, 35-36 (1950); H. R. Rep. No. 2319, 81st Cong., 2d Sess. 36-38, 41-42 (1950); H. R. Doc. No. 451, 81st Cong., 2d Sess. 5 (1950). And, while it appears that the Section 511 amendment was not supposed to change the existing rule for determining tax exempt status, we think that the Congressional purpose behind both it and the feeder provision[16] instructs us not to apply the destination test broadly but to deny exempt status to petitioner, an entity which has directed so much of its revenues toward improving its ability to compete as a commercial operation through the accumulation of large surpluses and the expansion of its income producing facilities.

Affirmed.

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[16] The feeder amendment, of course, was explicitly designed to take away tax exempt status from an entire class of organizations which had enjoyed an exemption up to that time. And, as noted above, to the extent that the treatment of organizations which are not feeders should be consistent with the change, the amendment also affected, to some degree, the exempt status of other organizations.

HAYS, *Circuit Judge* (dissenting):

Not only is the majority unable to cite a single authority in support of its conclusion, it is, as I see it, departing from a line of controlling authority firmly established for many years in our own circuit. Nothing in the case before us justifies this break with the past. In fact the equities of the case cry out for the continued application of that construction of the relevant statute which this court has so long followed.

The majority opinion dismisses as hardly worth serious consideration the contention that such activities at Camp Tanniment as the following are social welfare activities:

Weekly lectures on art, music, literature, current affairs, anthropology, psychology and human relations;

Weekly concerts by vocalists and instrumentalists of international reputation;

Daily concerts and lectures on music by a resident professional pianist;

An annual four day music festival featuring outstanding chamber music orchestras and string quartets;

A subsidized experimental theatrical group composed of a professional director, writers, composers, lyricists, arrangers, designers of scenery and costumes, actors, actresses, dancers and others, which produced new and original plays;

A professional orchestra for productions in the theatre;

A resident professional artist and art teacher giving instruction without charge in painting and drawing;

Exhibitions of painting and sculpture with an annual prize for painting.

The question which the majority opinion fails to answer is:

If these and the other activities of the camp were not for social welfare purposes, what *was* their purpose?

It is conceded that the camp is not operated for the purpose of earning a profit for any objective except an admittedly social welfare objective. The camp has no such "commercial purpose" as the Supreme Court found in *Better Business Bureau* v. *United States*, 326 U. S. 279 (1945). Its operation is not designed to benefit any group "economically." See *Consumer-Farmer Milk Coop.* v. *Commissioner*, 186 F. 2d 68 (2d Cir. 1950), cert. denied, 341 U. S. 931 (1951); *American Institute for Economic Research* v. *United States*, 302 F. 2d 934 (Ct. Cl. 1962), cert. denied, 372 U. S. 976 (1963).

To the extent that the camp was operated for "cultural" purposes, i.e. education in art, music, literature, politics, etc., the encouragement of experiment in the theater, and of excellence in music, sculpture and painting, then surely its purposes were social welfare purposes. To what other purpose is to be ascribed its provision of rest and recreation for young people interested in these cultural purposes? It seems to me to be impossible to find any rational

formulation of the purposes of the camp which can be phrased in any terms other than social welfare. It is significant, I believe, that the majority does not even attempt to formulate any alternative.

There is some suggestion in the majority opinion that the activities of the camp cannot be social welfare activities if a charge is made to the participants. This position proves on reflection to be absurd, since it would eliminate from tax exemption universities which charge tuition, hospitals which charge for medical services, art galleries and historical museums which charge admission fees, churches which charge pew rentals, and some examples of almost every other imaginable type of social welfare organization. In fact to concede that the activities of the camp would be social welfare activities if provided free of charge is practically to concede the correctness of petitioner's position.

But assuming *arguendo* that the cultural and recreational aspects of the operation of the camp do not have a social welfare purpose, then, by clear authority this circuit is bound to the destination test, i.e. the rule that the purpose of the activity is a social welfare purpose if the profits from the operation of the "business" are used for social welfare objectives. *Trinidad* v. *Sagrada Orden*, 263 U. S. 578 (1924); *Roche's Beach, Inc.* v. *Commissioner*, 96 F. 2d 776 (2d Cir. 1938); *Bohemian Gymnastic Ass'n Sokol* v. *Higgins*, 147 F. 2d 774 (2d Cir. 1945); *Debs Memorial Radio Fund, Inc.* v. *Commissioner*, 148 F. 2d 948 (2d Cir. 1945. See also *Willingham* v. *Home Oil Mill*, 181 F. 2d 9 (5th Cir), cert. denied, 340 U. S. 852 (1950); *Lichter Foundation, Inc.* v. *Welch*, 247 F. 2d 431 (6th

Cir. 1957); *Boman* v. *Commissioner*, 240 F. 2d 767 (8th Cir. 1957).

But, says the majority:

> "The destination test ought not to be used to permit an entity to escape taxation where, as here, so much of its revenues are devoted to expanding its commercial facilities and increasing its surpluses, and so little of its revenues are actually spent for social welfare activities, that it is factually clear that the primary purpose of the organization is not really the promotion of social welfare but the running of a commercial operation."

Not only is there no authority whatsoever for any such exception to the destination test, but the majority's analysis of the situation cannot survive scrutiny. What the majority is saying, in effect, is that no organization can properly be classified as a social welfare organization if it devotes a certain proportion of its income to expanding its facilities, whatever may be the purpose of such expansion. (Repeated use by the majority of the word "commercial" to describe the operations of the camp should not be permitted to prejudice consideration of the real character of those operations. They are, of course, not "commercial" operations in the ordinary or usual sense of that word since they are not designed for private profit.)

The majority's analysis is deficient in another material respect. It refers to the proportion of the petitioner's "revenue" which is devoted to "expanding its . . . facilities and increasing its surpluses." Both here and in the table reproduced on page 1711, the argument is presented as if "facilities" and "sur-

pluses" were two separate and distinct items, as if the camp had, in addition to its "facilities" some two million three hundred thousand dollars salted away somewhere in cash. Of course the largest part of petitioner's "surpluses" is represented by its "facilities." "Accumulated earned surplus" is merely the bookkeeping item of liability which balances assets.

Moreover, the "revenue" to which the majority refers is the gross revenue before deduction of any expenses. Using gross revenue in this way suggests that the majority would hold that any organization which has a large operation in money terms cannot be a social welfare operation. (The attempt to distinguish the destination cases is largely based on the argument that the operations in those cases resulted in smaller revenues than in the present case.) There is, of course, no justification whatsoever to support such a position. Nothing in the statute or in any of the cases suggests that the size of an operation has any bearing on whether it is a social welfare organization.

If we use the much more significant figure of net operating revenue, that is, gross revenue less expenses of operation, we find that, even excluding cultural programs and activities, the proportion of concededly social welfare expenditures ranges in the years 1956 to 1960 from 53% to 89% (and that it was 53% in 1956, the tax year in question). The following table also shows that if the expenditures for cultural activities are added to the expenditures which are admittedly for social welfare, a very large proportion of operating revenue went for the total of the two purposes.

	1956	1957	1958	1959	1960
Contributions to League for Industrial Democracy*	$ 4,000.00	$ 4,000.00	$ 4,000.00	$ 3,000.00	$ 3,000.00
Brandeis University	—	—	2,000.00	—	2,500.00
University of Scranton	—	—	—	—	100.00
Physical recreation expenditures	28,147.33	22,981.39	27,146.67	31,578.95	24,228.13
Total—"Costs of other activities"	32,147.33	26,981.39	33,146.67	34,578.95	29,828.13
"Cultural programs and activities" per Judge Pierce	82,746.41	87,178.45	97,792.47	91,164.60	108,071.51
(1) Total excluded by Judge Pierce from "social welfare" expenditure	114,893.74	114,159.84	130,939.14	125,743.55	137,899.64
(2) Operating revenue	119,147.03	232,487.58	276,082.70	258,311.51	219,619.38
(3) Adjusted operating revenue (item (2) less item (1) above)	84,253.29	118,327.74	145,143.56	132,567.96	81,719.74
(4) "Social welfare" expenditures per Judge Pierce	$ 44,684.76	$ 70,718.27	$ 78,194.54	$ 83,751.40	$ 72,610.13
(5) Per cent which item (4) is of item (3) above	53	60	54	64	89

* These contributions were for the education program, among the students, on campuses of universities in this country.

Additions to reserves ranged in the years 1956 to 1960 from 4% to 24% of operating revenue. The addition to reserves was 20% of operating revenue in 1956.

The majority seek to find support for their conclusion in the adoption of two statutes by Congress in 1950. The first, now Section 502 of the Code, withdrew exemption from "feeder" organizations. The other, now Section 511 of the Code, imposed a tax on the unrelated business income of certain organizations otherwise exempt from taxation. Admittedly neither of these statutes is applicable to petitioner. Far from lending support to the conclusion reached by the majority, the fact that Congress adopted these statutes to remedy the particular situations with which they dealt, excluding from their application the social welfare organizations described in Section 501(c)(4), would seem to support the conclusion that Congress was satisfied with the working of the statute applicable to petitioner and intended no change. However, we need not speculate on the Congressional purpose since the Report of the Committee on Finance on the Revenue Bill of 1950 (Sen. Rep. No. 2375, 81st Cong., 2d Sess., 1950-2 Cum. Bull. 483, 504-505) stated with respect to the statutory amendments:

> "It is important to note that many organizations now exempt from income tax under section 101 of the Internal Revenue Code [of 1939] are not affected by these tax measures. * * * These include * * * 'civic leagues; social welfare organizations'; * * *
>
> * * * In fact it is not intended that the tax

> imposed on unrelated business income will have any effect on the tax-exempt status of any organization. An organization which is exempt prior to the enactment of this bill, if continuing the same activities, would still be exempt after this bill becomes law. * * *"

If we are to look to other statutes for support for one position or the other, the majority's view that the accumulation of surplus is a ground for withdrawing exemption is dealt a powerful blow by consideration of Section 504 of the Code which expressly provides that exemption shall be denied charitable and educational organizations "if the amounts accumulated out of income during the taxable year or any prior taxable year and not actually paid out by the end of the taxable year—are unreasonable in amount or duration in order to carry out the charitable, educational, or other purpose or function constituting the basis for [their] exemption . . ." Social welfare organizations are not subject to the provisions of Section 504. The majority is, then, clearly in error in reading the limitations of Section 504 into the section on social welfare organizations. See *Erie Endowment* v. *United States*, 316 F. 2d 151, 156 n. 21 (3d Cir. 1963).

It seems to me quite clear on the basis of logic and authority, as well as because of the equities of the case with which we are presented, that the decision of the Tax Court must be reversed.

APPENDIX B

Judgment

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the Twenty-fourth day of April One Thousand Nine Hundred and Sixty-four.

Present:

HON. STERRY R. WATERMAN,
HON. J. JOSEPH SMITH,
HON. PAUL R. HAYS,

Circuit Judges

PEOPLE'S EDUCATIONAL CAMP SOCIETY, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Appeals from The Tax Court of the United States

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

Judgment

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is affirmed.

A. DANIEL FUSARO
Clerk

United States Court of Appeals
Second Circuit
Filed April 24, 1964
A. Daniel Fusaro, Clerk

APPENDIX C

FINANCIAL SUMMARY OF PETITIONER'S ACTIVITIES

	1922-1940	1941-1955
Gross revenue from all sources (before deduction of any costs or expenses) from:		
Guests	$ 2,495,117.95	$10,310,788.13
Sandyville	364,191.55	432,768.55
Interest	11,971.53	25,419.64
Mailly Educational Fund	—	112,260.19
School Building	—	(4,125.18)
Other gross revenue	25,004.15	68,246.30
(1) Total gross revenue from all sources	2,896,285.18	10,945,357.66
(2) Operating costs (culinary, administrative, maintenance, housekeeping, occupancy, Sandyville, general publicity, depreciation, and unclassified)	2,300,981.40	4,986,521.75
(3) Operating revenue—item (1) less item (2)	595,303.78	3,657,854.51
Expenditures for—		
(4) Costs held by the Tax Court and the court of appeals to be for "social welfare activities" under Section 501(c)(4) of the 1954 Internal Revenue Code	8,863.86	127,903.93
(5) Costs held by the Tax Court and the court of appeals to be for "cultural programs and activities" but, with the dissenting opinion of Circuit Judge Hays, not to constitute "social welfare" expenditures under Section 501(c)(4) of the 1954 Code	113,863.28	844,417.47

Appendix C

Contributions:		
(6) To the Rand School of Social Science	135,440.16	492,989.79
(7) Others (League for Industrial Democracy, International Rescue Committee, American Labor Archives, American Labor Committee, Jewish Labor Committee, United Jewish Appeal, hospitals, community chest, Y.M.C.A., and flood relief)	4,292.50	125,275.58
(8) Physical recreation	27,978.02	225,556.61
(9) Unclassified costs (1930-1933)	67,512.62	—
(10) Total expenditures (items (4)-(9))	357,950.44	1,816,143.38
(11) Balance (item (3) less item (10)) —addition to Reserve	237,353.34	1,841,711.13
Composition of Reserve Account:		
Land and buildings (net after depreciation)	213,259.35	652,761.98
Equipment (net after depreciation)	29,157.63	128,401.22
Mailly Educational Fund	—	539,240.63
Cash	10,890.09	382,398.32
Other assets (less liabilities)	16,612.38	151,880.73
Total additions to net assets [1]	$ 269,919.45	$ 1,854,682.88
(12) Percentages of operating revenue expended by petitioner exclusive of additions to capital assets (per cent which item (10) is of item (3))	60.127	50.268

(R. 46a-51a).

[1] The excess of this total over item (11) represents accounting adjustments in the Reserve Account (R. 51a).

APPENDIX D

Financial Summary of Petitioner's Activities

The financial summary of petitioner's activities during each of its fiscal years ended September 30, 1956 through 1960 is shown below (the figures are arrived at in the same manner as the corresponding figures shown in Appendix C, *supra*):

	1956	1957	1958	1959	1960
Gross revenue	$942,632.55	$979,579.07	$1,078,412.50	$1,015,178.53	$1,115,932.39
Less operating costs	743,485.52	747,091.19	802,329.80	756,867.02	896,313.01
(1) Operating revenue	199,147.03	232,487.88	276,082.70	258,311.51	219,619.38
Social welfare costs	44,684.76	70,718.27	78,194.54	83,751.40	72,610.13
Contributions	4,000.00	4,000.00	6,000.00	3,000.00	5,600.00
Cost of cultural activities	82,746.41	87,178.45	97,792.47	91,164.60	108,071.51
Physical recreation	28,147.33	22,981.39	27,146.67	31,578.95	24,228.13
(2) Total	159,578.50	184,878.11	209,133.68	209,494.95	210,509.77
(3) Balance—addition to Reserve	39,568.53	47,609.77	66,949.02	48,816.56	9,109.61
Composition of Reserve account:					
Land and buildings	119,586.07	110,086.87	52,339.39	(48,763.91)	211,289.54
Equipment	30,989.14	(10,487.30)	8,959.22	(8,802.55)	117,348.05
Library in New York City	20,325.00	(1,875.80)	(153.57)	(3,423.97)	(2,652.16)
Improvements	—	4,451.60	(338.68)	(1,133.07)	(1,489.97)
Inventory	56,327.93	—	4,985.24		
Total above	227,228.14	102,175.45	65,791.61	(62,123.50)	324,495.46
Mailly Educational Fund	5,104.20	(73,598.19)	11,480.00	11,630.00	11,632.03
Cash	(147,785.88)	16,898.23	107,018.80	(75,089.06)	(102,311.18)
Other assets less liabilities	16,931.71	35,541.90	(115,655.01)	176,086.76	(221,565.31)
Total additions to net assets	$101,478.17	$ 81,017.39	$ 68,635.40	$ 50,504.20	$ 12,251.00
Percentages of operating revenue:					
Item (2) of item (1)	80.131	79.521	75.750	81.102	95.852
Item (3) of item (1)	19.869	20.479	24.250	18.898	4.148
Total	100.000	100.000	100.000	100.000	100.000

(R. 46a-51a)

Appendix D

FINANCIAL SUMMARY OF PETITIONER'S ACTIVITIES (*Continued*)

The table below is stated on the assumed basis, *arguendo*, of the Tax Court and the majority opinion of the court of appeals, that petitioner's expenditures for social welfare activities are limited to those found by the Tax Court and affirmed by the majority opinion of the court of appeals.

	1956	1957	1958	1959	1960
Operating revenue	$199,147.03	$232,487.88	$276,082.70	$258,311.51	$219,619.38
Less costs excluded as social welfare expenditures	114,893.74	114,159.84	130,939.14	125,743.55	137,899.64
Revised operating revenue	84,253.29	118,328.04	145,143.56	132,567.96	81,719.74
Social welfare costs	44,684.76	70,718.27	78,194.54	83,751.40	72,610.13
Per cent of social welfare costs of revised operating revenue	53	60	54	64	89

(R. 46a-51a)

APPENDIX E

ANALYSIS OF CASES CITED IN THE PETITION, SUPRA, PP. 20-22

Roche's Beach, Inc. (pet., *supra*, p. 21), was a New York business corporation which owned and operated a public bathing beach with 3,000 bath houses. It also owned and rented six dwelling houses and a garage. In 1931, the year in question, it had gross revenue of $99,947, expenses of $76,703 (or 76.7% of the gross revenue), and net income of $23,243, which it paid over to a charitable foundation. In 1934 it received $406,687 on a condemnation claim which it had since 1931 and in 1934 invested in U.S. Treasury bonds.

Bohemian Gymnastic Ass'n (pet., *supra*, p. 21), a New York membership corporation, for charges which it made, operated a bowling alley, a restaurant, a bar, a gymnasium, and other facilities. Its gross revenue for the year involved was $74,025, its expenses in that year were $69,532 (or 94% of the gross revenue), and net income amounted to $4,492. The Court of Appeals for the Second Circuit said:

> "* * * In the case at bar the ultimate object to which the corporate income is destined is to promote *education*. * * * Therefore, Bohemian is exempt from the Social Security Tax."

Debs Memorial Radio Fund, Inc. (pet., *supra*, p. 21), a New York stock corporation, as its sole activity, owns and operates a radio station from which it broadcasts commercial and cultural programs, and from which it derived gross revenue for each of the

years 1939 through 1942 ranging between $284,294 and $323,843 (for 1940, the year involved). Its annual net income in those years was between $6,053 and $30,700 (for 1940); and the per cent of net to gross income varied between 2.5% and 9.5% (for 1940). The Court of Appeals for the Second Circuit said:

> "* * * Nor is it fatal to exemption that substantially all of petitioner's income is derived from commercial activities since the purpose of making profits has been to enable it to broadcast its educational, civic and cultural programs without charge. * * * the fact that petitioner may use some of the profits derived from commercial broadcasting for improvement of its radio service should not deprive it of exemption since its ultimate purpose is the maintenance of a free forum for educational, cultural and civic purposes without financial gain to any individual."

In the *Howes Leather* case (pet., *supra*, p. 22), a "feeder" corporation to New York University in 1947 purchased the capital stock of eleven leather tanning and cutting corporations, which were a substantial factor in the production of sole leather in the United States, for about $30,212,487, paid by $6,042,497 in cash (with borrowed funds), $4,531,873 in a short term promissory note, and $19,638,116 in a first mortgage twenty year bond of the Leather Company, which thereafter operated the leather business. This business, for the year 1946, had sales and profits (after renegotiation) of $41,243,572 and $7,161,797, respectively (see 30 T.C. 909, 917).

In the *Mueller* case (pet., *supra*, p. 22), a "feeder" corporation to New York University, with borrowed

funds, purchased for $3,495,057, and after August 28, 1947 operated, a large business engaged in the manufacture and sale of macaroni and allied products. The average annual expenditures for advertising this business for the five years ended with 1947 were about $273,000; its *net* income for 1946 was $962,366; the *net* income of the Mueller Company for the four last months of 1947 was $359,890; and the gross sales of the business for the calendar year 1947 amounted to over $9,000,000, and the selling, delivery, administrative, and general expenses for that period amounted to about $1,380,000 (see 14 T.C. 922, 925). Citing *Trinidad* and cases of courts of appeals, the Third Circuit Court of Appeals said:

> "* * * These cases hold, along with others, that the exclusive purpose required by the statute [Section 101(6) of the Internal Revenue Code, 26 U.S.C., 1946 ed. §101(6)] is met when the only object of the organization involved originally was and continues to be religious, scientific, charitable or educational, without regard to the method of procuring the funds necessary to effectuate the objective."

In the *Lesavoy* case (pet., *supra*, p. 22), the Third Circuit Court of Appeals in 1956 said (238 F. 2d 589, 590):

> "The Commissioner invites us to reconsider and overrule our decision in C. F. Mueller Co. v. Commissioner, 3 Cir., 1951, 190 F. 2d 120. This we do not propose to do. The case was decided after careful consideration and followed the pattern already set in the Second Circuit. We abide by it."

In the *Lichter* case (pet., *supra*, p. 22), the Foundation performed a masonry construction contract from which it realized net profits for its fiscal years 1949, 1950 and 1951, the years involved, of $200,501, $140,418 and $182,698, respectively, or a total of $503,609. From its organization in 1948 through 1951 its only other income, consisting of contributions, interest and dividends, aggregated $83,323; and its expenditures not related to the construction contract then aggregated $17,552. The government argued against exemption on the ground that the Foundation was operated in competition with private business; but the court of appeals, in view of the destination of net income test established in the *Trinidad* case and followed by the courts of appeals, and the legislative history of the exemption statute, held the Foundation exempt on that business.

In the *Jordan* case (pet., *supra*, p. 22), where the Commissioner urged that the application of funds to "social advancement, including music and the arts" is not a use for the exempt purpose, the Seventh Circuit Court of Appeals said (210 F.2d 885, 888):

> "* * * We think this argument is wholly without merit. * * * It is obvious, we think, that the use of funds for social advancement, including music and the arts, would tend to 'promote the well doing and well being of social man.' * * *" [Citing cases]

In the *Southeastern Fair* case (pet., *supra*, p. 22), the Fair Association made a profit on its annual fair from admission charges and fees paid by amusement concessionaires and commercial exhibitors. The profit was used to pay salaries and wages to employees and

to maintain, repair and improve the buildings and grounds. The fair was held exempt as an entity organized and operated exclusively for educational purposes.

In the *Knapp Brothers* case (pet., *supra*, p. 22), cognate with the *Mueller* case, the corporation held exempt in March 1948 purchased a large business, engaged in the manufacture and sale of shoes, for $5,100,000 which it satisfied with a down payment of $918,000 (with borrowed funds) and collateral mortgage notes due in 20 years. The business was so successful that within little more than a year the corporation, out of its profits therefrom, paid the loan of $918,000 and by December 26, 1951 paid off the notes; but during this period made no cash contributions to New York University. As to the Government's objection that the corporation's income went to the Knapps during those years, and none of it to the University, the Court of Claims said (142 F.2d 899, 902):

> "* * * But the payment of the plaintiff's debt to the Knapps added, dollar for dollar, to the assets of the University. The fact that the money was saved, and not currently spent, is immaterial."

In *Rio Farms, Inc.* (pet., *supra*, p. 20), where it was held exempt from capital stock tax as "not organized for profit but operated exclusively for the promotion of social welfare," the court of appeals said (205 F.2d 68, 73):

> "* * * the fact that the persons who receive the benefit of its activities are not paupers or

people living on a substandard scale, would not any more defeat the claim of this corporation to exemption from the corporate taxes assessed against it than the fact that educational opportunities are availed of by large numbers of people who can afford to pay for them would defeat the exemption of great Universities, Art Galleries, and other non-profit educational institutions. The laws of the United States and of the states have been framed with the idea of promoting such corporations, enterprises, and institutions, rather than turning to the government for the necessary funds. * * *

If the Congress wishes to take away the tax exemption accorded by the statute in situations of the kind presented here, it can do so as easily as it did in the 1950 amendment" [relating to the "feeder" organizations].